

**Quarterly Report**  
**01 October 2013 - 31 December 2013**

*Prepared by IBSER for grant*  
*# AID-121-A-11-00006*

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## Abbreviations

AFO	Association of Financial Officers of Ukraine
AUC	Association of Ukrainian Cities
CLC	Commercial Law Center
CPER	Combined Program Evaluation and Review
DHA	District Heating Assessment
EC	European Commission
ESCO	Energy Servicing Company
EU	European Union
FAF	Foreign Assistance Framework
GOU	Government of Ukraine
HCSS	Housing and Communal Services Sector
IBSER	Institute for Budgetary and Socio-Economic Research
LG	Local Government
LINC	Local Investment and National Competitiveness
MBR	Municipal Budget Reform
MFF	Municipal Finance Facility
MFSI	Municipal Finance Strengthening Initiative
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NGO	Non-Governmental Organization
OSR	Own-source Revenues
PFR	Public Finance Review
PMP	Performance Monitoring Plan
PPB	Performance Program Budgeting
RTI	Research Triangle Institute
SEFR	Support for Economic and Fiscal Reform
TSA	Treasury Single Account
USG	United States Government
WB	World Bank

## Executive Summary

### *PUBLICATIONS AND REPORTS*

- MFSI-II project analysts prepared the publication, *Budget Monitoring for January–September 2013*, drawing from the Treasury Department’s preliminary data. The document includes analyses of the latest State and local budget execution trends and relevant legislative acts approved during the reporting period.
- The Project prepared three monthly monitoring reports on the implementation of the State and local budgets for the period from August 2013 to October 2013.
- In December 2013, MFSI-II experts prepared an updated a version of the *Planning of Local Budgets Based on the Performance Program Budgeting Method* handbook. It was the fifth such version developed during implementation of the MFSI and MFSI-II projects (2008 through 2013). This handbook contains the training, normative, and methodological materials required for studying the methods and applying the practices of local budget planning based on the Performance Program Budgeting (PPB) method. The updated handbook reflects all the latest changes in PPB legislation.

### *MEETINGS AND TRAINING*

- In the reporting period, acting to implement a commission of the Ministry of Finance, the MFSI-II Project experts launched a series of regional PPB trainings for specialists of the State Treasury Service of Ukraine. The first trainings were held in the Crimea, cities of Kyiv and Sevastopol, and in the Kyiv, Chernihiv, Ternopil, Kharkiv, Zhytomyr, Lviv, Donetsk, Cherkasy, Odesa, and Zaporizhzhya oblasts.
- In collaboration with the Kirovohrad Center of Retraining and Qualifications Enhancement, MFSI-II experts held a training on practical PPB implementation on 2 October 2013. On 10 October, a similar event was held at the Zakarpattia Regional Retraining and Qualifications Enhancement, the first training at this location. Participants included heads of budgetary organizations and institutions, and a training-of-trainers approach was used to build the capacity of local PPB specialists who would go on to train others.
- On 4 October 2013, a regular meeting of the Interbudgetary Relations Reform Task Force took place at the Ministry of Finance. The meeting was attended by specialists from the Ministry of Finance, State Treasury Service, line ministries, MFSI-II experts, and researchers. Task force members supported the proposals of MFSI-II experts for improving the standard lists of budget programs.
- On December 24, 2013, the National Advisory Board (NAB) held a meeting on effective public finance management. As a result, participants approved MFSI-II experts’ suggestions on improving the PPB methodology and legislative basis. These changes will aid in settling problems which may arise when forming local budgets based on PPB.
- On December 25, 2013, the Interbudgetary Relations Reform Task Force held its regular meeting in the Ministry of Finance of Ukraine. The task force members discussed and approved steps to improve PPB software developed by the Ministry of Finance of Ukraine for local level government. Ministry of Finance representatives highly praised the work of MFSI-II experts in implementing PPB at the local level.
- Based on a unified selection methodology, seven cities have been selected to participate in Year Three of the Project. Each city has agreed to a Memorandum of Cooperation, through which IBSER will help increase the local government’s energy efficiency by introducing energy expenditure

monitoring in the local budget and identifying and using the actual economy of budget resources generated through energy-saving activities.

#### *DRAFT AMENDMENTS AND RECOMMENDATIONS*

- Improving upon the MFSI-II Project's PPB methodology, IBSEER experts completed performance indicators for the Education and Culture sectors, amendments to the Standard Lists of Budget Programs, and amendments to the typical list of Environment and population health performance indicators for local budget programs under their expenditures. In November, these proposed amendments and indicators were forwarded to the Ministry of Finance for review and approval with the goal of reducing the number of budget programs, optimizing local government performance indicators, fostering improved transparency of the budget process, and reducing the administrative burden on local government employees.
- In December 2013, MFSI-II experts finalized and forwarded "Letter No.267 of 4 December 2013" to the Ministry of Finance. The letter includes a new recommendation of how to calculate expenditures and credit provision for planning the next two budget periods by key spending units of local budgets. This methodology also includes a system for monitoring and evaluating budget energy expenditures based on PPB.
- MFSI-II experts updated recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector and presented them at a session of the National Advisory Board on December 24, 2013. If adopted, these incentives will fulfill the terms and conditions of the loan for implementing energy effective projects, and improve solvency of local governments' energy budgets.

## List of major activities for the next quarter

### PUBLICATIONS AND REPORTS

- IBSER will prepare three monthly monitoring reports on the implementation of the State and local budgets for the period from November 2013 to January 2014.
- MFSI-II experts will prepare report on the number of trainings held and the number of specialists who participated in trainings with a breakdown by gender and by municipal enterprises.
- MFSI-II experts will analyze the current energy budget expenditures of the seven selected cities.
- By the end of the next quarter, MFSI-II experts plan to prepare the *Budget Monitoring for January-December 2013*.
- MFSI-II experts will prepare the *Innovative Practices of the Local Finance Management* publication in March 2014.

### MEETINGS AND TRAINING

- A National Advisory Board meeting is scheduled for March 2014.
- MFSI-II experts will conduct a training on budget issues for NGOs.
- IBSER will provide organizational support to the Ministry of Finance Intergovernmental Working Group and organize its meeting in February 2014.
- As per the schedule approved by the Ministry of Finance in August 2013, MFSI-II experts will continue to conduct PPB training sessions to support the introduction of PPB at the local level.
- MFSI-II experts and the Ministry of Finance of Ukraine will continue working together to implement the PPB method at the local budget level as part of the budget reform pursuant to the Program of Economic Reforms for the year 2010-2014 entitled "Prosperous Society, Competitive Economy, Effective Government."
- MFSI-II experts will provide consultations to the staff of municipal enterprises on how to monitor and evaluate the energy performance projects and improve the efficiency of providing financial justification for communal service enterprises.

### DRAFT AMENDMENTS AND RECOMMENDATIONS

- MFSI-II experts will prepare proposals for improving the methods of performance monitoring and evaluation of local PPB-based budget programs.

## Key Milestones and Major Deliverables Summary

### **Objective A: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine**

- Drafts amendments to joint orders of the Ministry of Finance and line ministries that approve standard lists of budget programs and their performance indicators developed

*Timeline: October – December 2013*

- Proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for district budgets developed

*Timeline: October 2013 – September 2014*

- The PPB Handbook improved due to changes in legislation, disseminated, and published on the website

*Timeline: October – December 2013*

- Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex

*Timeline: October – December 2013 and July – September 2014*

- Working Group

*Timeline: October 4, 2013, December 25, 2013*

### **Sub-objective A.1: Ensure institutional sustainability of the PPB training program(s).**

- Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender

*Timeline: October 2 and 10, 2013*

### **Objective B: Develop and introduce financial practices that foster energy efficiency in 15 selected cities.**

- Seven Ukrainian cities for Year Three of the project are selected using the developed unified methodology

*Timeline: October – December 2013*

- Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector are updated and presented at a session of the National Advisory Board

*Timeline: October – December 2013*

**Objective C: Enhance public awareness of the public budgeting process, revenues and expenditures**

- Monthly monitoring of national and local budget implementations

*Timeline: second week of every month*

- Monitoring of the budget and fiscal impacts on local budgets in form of a full-scale analysis of the budget process

*Timeline: December 31, 2013*

- Preparation and organization of the National Advisory Board

*Timeline: December 24, 2013*

- Preparation of Electronic bulletin

*Timeline: October, 2013*

## **Tasks and Subtasks**

***Objective A: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine***

**Task 1.1: Provide assistance to the GOU (Ministry of Finance, State Treasury of Ukraine, local finance departments, key spending units, specifically) in conducting state-supported pilot programs on Performance Program Budgeting (PPB) and their implementation in local budgets in Ukraine**

***Sub-task 1.1.1: Develop and formalize system to monitor and evaluate execution of local budget programs for all local government functions***

In 2011, IBSER developed the draft methodology for monitoring and evaluating the efficiency of budget program performance. The said proposals were considered at a meeting of the NAB on December 28, 2011, which was attended by members of Parliament, experts of the Verkhovna Rada Budget Committee and other parliamentary committees, Ministry of Finance, and local governments.

The revised methodology was submitted in January 2012 to the Ministry of Finance. The Ministry of Finance of Ukraine forwarded the formula-based methodology developed by IBSER to all participants of the national experiment of PPB implementation under its letter No.31-05010-14-8/4651 dated 13 February 2013.

MFSI-II experts have piloted the methodology of comparative analysis of budget programs based on reporting data of local budgets. More than 750 budget programs of oblast, raion, and city budgets executed in 2012 passed through this evaluation. The results were presented by MFSI-II experts at a joint meeting of the Interdepartmental Working Group and the National Advisory Board on effective management of public finance, which took place on 25 June 2013.

The work is currently in progress to finalize and improve the methodology.

During the third year of implementation, MFSI-II will conduct a comparative efficiency analysis of budget programs based on the reporting data of local budgets. Based on the results of the conducted work, proposals will be prepared to improve the methodology of comparative efficiency analysis of budget programs.

***Deliverable: Report on the results of the monitoring and evaluation of the performance of PPB-based budget programs***

***Timeline: March 2014***

***Deliverable: Proposals for improving the methods of monitoring and evaluation of performance of the local PPB-based budget programs***

***Timeline: January – March 2014***

***Sub-task 1.1.2: Complete the legislative, regulatory and methodological framework taking into account the specifics of PPB implementation at various levels of local budgeting***



In 2011-2012, the Government of Ukraine reviewed proposals prepared by MFSI-II experts for amending the Principal Normative-Legal Act, which regulates the use of PPB methodology at the local level. These proposals are reflected in amendments to the Ministry of Finance (MOF) Order No.679 "On Certain Issues of Conducting an Experiment of Implementation of the Performance Program Budgeting Method of Formulation and Execution of Local Budgets" dated 8 June 2012, No.690, and dated 26 November 2012, No.1221, and registered by the Ministry of Justice of Ukraine.

MFSI-II experts have prepared and submitted to MOF the amendments to MOF Order of 14 February 2012, No. 97 "On Approving the Structure of the Code of Program Classification of Expenditures and Crediting of Local Budgets and the Codifier of Numbering of Standard Lists of Local Budget Programs." The amendments were approved by MOF orders of 4 October 2011, No.1249, of 15 October 2012, No.1101, and of 20 December 2012, No.1386.

MFSI-II experts have reviewed the existing regulatory and legislative framework required for PPB implementation in local budgets and prepared proposals for its improvement. These proposals were submitted for consideration of the participants in the meeting of the National Advisory Board (NAB) on effective public finance management, which was held on 4 October 2013. The participants have supported every proposal made by the MFSI-II Project.

Amendments have been enacted to the Standard lists of budget programs and performance indicators for the delegated functions in the departments of Public Administration, Social Protection and Social Security, Social Protection of Family and Children, and Physical Culture and Sport, as well as similar provisions for the disbursement of expenditures for the implementation of own functions of local budgets. These amendments have been approved by orders of the Ministry of Finance and line ministries (No.1116/673 of 24 October 2012; No. 1060/630 of 8 October 2012; No.1202/1291 of 19 November 2012; No. 1035 of 27 September 2012; and No.35/41 of 22 January 2013). In addition, the experts provided their proposals to modify the Standard lists of budget programs and the performance indicators for the expenditures in the departments of youth and culture. The issued orders incorporate all the proposals made by MFSI-II experts with regard to reducing the number of budget programs and their performance indicators.

MFSI-II experts developed a standard program classification of expenditures and crediting of local budgets and a comparative table of its correspondence to the existing provisional classification of expenditures and crediting of local budgets. New approaches to program classification of local budgets were approved at a joint meeting of the Task Force on Interbudgetary Relations Reform and the National Advisory Board on Effective Management of Public Finance, held on 25 June 2013. The meeting participants recommended modifications to all documents used in the budget process. The amendments were approved by the MOF order No.705 of 26 July 2013.

Experts of the MFSI-II Project suggested a full-scale implementation of PPB methodology when formulating the budget programs aimed at improving the environmental situation in the regions and health of the population. To this end, the MFSI-II experts developed performance indicators which will evaluate the impact of budget programs on atmospheric air, water resources, green plantations, forestry, land reclamation, conservation of the natural and reserve fund, health of the population, etc. These indicators were discussed on 4 October 2013 at a meeting of the National Advisory Board (NAB) on Effective Public Finance Management, were further reviewed by the Interdepartmental Working Group, and later entered into a supervised directive of the Ministry of Finance.

In order to implement the State support of the PPB methodology for all oblast, rayon and oblast-significant municipal budgets during the third year of implementation, IBSE will:

- assist in developing proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for the budgets of associations of territorial communities, which will be established according to legislation;
- help Ministry of Finance of Ukraine develop proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for the budgets of associations of territorial communities, which will be established according to legislation; and

- prepare draft amendments to the joint orders of MOF and line ministries that approve the standard lists of budget programs and their performance indicators for all functions of local budgets.

*Deliverable: Proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for the budgets of associations of territorial communities, which will be established according to legislation developed*

*Timeline: October 2013 – September 2014*

MFSI-II experts are continuing their work of improving the regulatory and legislative framework, which regulates implementation of Performance Program Budgeting for local budgets. The amendments are intended to ensure common approaches to a full-fledged transition to PPB of local budgets at all levels.

PPB-based planning of local budgets as the main and only method of budget planning and execution (rather than a pilot method) will start in 2014. Therefore, the effective documents will need to be developed, the procedures changed, and the rules of applying the PPB method must be implemented on a regular basis rather than as an experiment. Work has started to prepare changes to one of the key regulations of the Ministry of Finance, which stipulates the rules and procedure of PPB budgeting at the local level (MOF Order No.679 of 9 July 2013). The order approved the document forms to be used in the process of PPB-based formation and execution of local budgets, rules for compiling these forms, as well as the guidelines for participation of responsible implementers of budget programs in the budget process.

*Deliverables: Drafts amendments to joint orders of the Ministry of Finance and line ministries that approve standard lists of budget programs and their performance indicators (if needed)*

*Timeline: October – December 2013*

MFSI-II experts have developed amendments to the Standard Lists of budget programs and their performance indicators in the Education and Culture departments, approved by joint orders of MOF and line ministries.

MFSI-II experts have also developed amendments to the Typical List of performance indicators of local budget programs for the expenditures disregarded when determining the amount of intergovernmental transfers. The developed indicators characterize the impact from using the budget funds on the environment and population health.

The proposals for incorporating the amendments were sent to the Ministry of Finance.

Adoption of the proposed amendments will help reduce the number of budget programs in the respective departments and optimize their performance indicators.

See folder “Deliverables”

***Sub-task 1.1.3: Develop formats and procedures for treasury-based services of local budgets to improve the budget software used by the State Treasury; field-test these products within the local governments that have been a part of the pilot program***

During the first and second years of project implementation, the MFSI-II experts have reviewed the

existing reporting forms on execution of local budgets, which are compiled by the State Treasury of Ukraine. The analysis has shown that these reports need amending in the context of PPB budgeting, namely: it is necessary to take into account the special circumstances of execution of local budgets using the codes of program classification of expenditures and crediting of local budgets.

The special features in generation of reports according to PPB were brought for consideration of the members of the National Advisory Board on efficient public finance management and approved at the meeting of 27 April 2012. Based on the results of this work, the IBSER proposals for improving the reporting forms on execution of local budgets, which are compiled by the State Treasury Service of Ukraine, have been developed and submitted to the Ministry of Finance of Ukraine.

Proposals of MFSI-II experts were incorporated into the modification of forms of financial and budget reports on execution of local budgets approved by Order No.14 of the Ministry of Finance of Ukraine dated 16 January 2013.

The Order of the Ministry of Finance dated 25 November 2012, No. 1126 "On amending the Order of the Ministry of Finance of Ukraine of 30 January 2012, No. 60" approved amendments to the forms of budget reports on execution of local budgets, which incorporate the proposals made by MFSI-II experts with regard to improving the existing reporting forms on execution of local budgets.

IBSER will provide technical support for improving the formats and procedures of treasury servicing of local budgets. It will support the implementation of the preparatory work needed for introducing the generation of reports on the execution of local budgets based on the codes of program classification of expenditures and crediting of local budgets.

Within the third year of implementation, should amendments be made to the PPB methodology for local budgets, IBSER shall:

- carry out a new review of the existing reports on the execution of local budgets used by the Treasury and draft proposals with regard to their amendment in the context of PPB.
- prepare proposals for improving the procedures for the treasury servicing of local budgets. It will submit proposals with regard to such amendments to the legislative framework that defines Treasury functions.
- develop proposals for the requirements specification to improve the budget software used by the State Treasury and assist with its field-testing after installation in the pilot regions.

*Deliverables: The proposals for improving the existing reporting forms, as well as new forms for the treasury servicing of PPB-based budgets developed*

*Timeline: January – June 2014*

*Deliverables: The proposals for improving the procedure for the treasury servicing of local budgets developed. The proposals with regard to amendments to the legislative framework, which defines Treasury functions developed (if needed)*

*Timeline: October – December 2013 and July – September 2014*

Treasury execution of local budgets in the PPB format will start in 2015. The proposals prepared by MFSI-II experts during Year Two of the Project have already been approved.

See "Quarterly Report 01 July 2013 - 30 September 2013"

*Deliverables: The proposals for the requirements specification to improve the budget software used by the State Treasury developed*

*Timeline: October 2013 – September 2014*

The proposals of MFSI-II experts for improving the Treasury servicing of local budgets when using PPB were discussed at a meeting of the task force at the Ministry of Finance on 25 December 2013. The meeting participants noted good results from pilot operation of the software by finance departments and from the State Treasury Service actions aimed at improving the relevant software.

This work would aid local governments in using the PPB methodology for formulating and executing local budgets, as well as generating transparent budget reports.

#### ***Sub-task 1.1.4: Prepare and disseminate a PPB hand book***

In 2011, MFSI-II experts prepared a *Modern Tools of Financial Planning* handbook, which contains the training, normative, and methodological materials needed for learning the methods and applying the practices of local budget planning based on Performance Program Budgeting. The methodology of financial justification of strategic documents and principles of financial analysis of investment projects are provided.

In 2011-2013, MFSI-II experts prepared and updated 3 versions of the *Planning of Local Budgets Based on the Performance Program Budgeting Method* handbook, which contains the training, normative, and methodological materials required for studying the methods and applying the practices of local budget planning based on the Performance Program Budgeting method. This handbook reflects all the latest changes in the PPB legislation.

Should any significant changes be made in the methodological framework of Performance Program Budgeting for local budgets, this publication will be amended accordingly. An updated version of the *Modern Tools of Financial Planning Handbook* will be posted on the IBSE website and disseminated during PPB trainings.

*Deliverable:* *The PPB Handbook improved due to changes in legislation (if needed), disseminated, and published on the website*

*Timeline:* *October – December 2013*

In December 2013, MFSI-II experts prepared an updated fifth version of the *Planning of Local Budgets Based on the Performance Program Budgeting Method* handbook, which contains the training, normative, and methodological materials required for studying the methods and applying the practices of local budget planning based on the Performance Program Budgeting method. This handbook reflects all the latest changes in the PPB legislation.

An electronic version of this handbook has been prepared for ease of use. Its use will help improve the knowledge of local-level specialists about the modern tools of financial planning. The electronic version of this handbook will be disseminated during PPB trainings for local offices of the State Treasury and local finance departments.



See folder “Deliverables”

***Sub-task 1.1.5: Assess the need for additional PPB training in those municipalities that participated previously in the Municipal Budget Reform Project***

IBSER will develop a questionnaire and conduct an analytical survey of the municipalities that participated in the Municipal Budget Reform Project, which will then be used for assessing the status of using the PPB methodology and the need for conducting special PPB training sessions for such municipalities (will be conducted within Sub-task 1.1.6).

*Deliverable:* *An analytical memo describing the results of surveying the municipalities that participated in the Municipal Budget Reform Project*

*Timeline:* *January – March 2014*

*Deliverable:* *Special trainings for the municipalities that participated in the Municipal Budget Reform Project (if needed)*

*Timeline:* *April – June 2014*

***Sub-task 1.1.6: Train at least 8,000 budget officers from local finance departments, key spending units, as well as territorial departments of the Treasury***

In order to efficiently implement PPB at the local level, it is necessary to improve the qualifications of the personnel of local finance departments, the specialists of the spending units and recipients of budget funds, as well as of the representatives of regional and local offices of the State Treasury. Thus, since the project launch, the MFSI-II experts have conducted a series of similar PPB trainings. Such trainings were delivered in all oblast centers for specialists of each region. Overall, 4,805 local-level specialists passed through this training since the start of the Project, including 4,278 women and 527 men (without the training under Sub-objective A.1).

At the regional level, during the third year of MFSI-II project implementation, IBSEER will deliver a series of cluster trainings, which will cover more than 2,000 local offices of the State Treasury and local finance departments.

*Deliverable:* *Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex*

*Timeline:* *October – December 2013 and July – September 2014*



In the reporting period, in response to a commission from the Ministry of Finance, the MFSI-II Project experts launched a series of regional PPB trainings for specialists of the State Treasury Service of Ukraine. This effort is a logical continuation of Phase II of the experiment of PPB implementation for local budgets.

The first trainings were delivered in Crimea, the cities of Kyiv and Sevastopol, and the Kyiv, Chernihiv, Ternopil, Kharkiv, Zhytomyr, Lviv, Donetsk, Cherkasy, Odesa, and Zaporizhzhya oblasts. Participants included structural unit specialists of the State Treasury Service Principal and rayon offices and PPB implementation coordinators from each of the regions.

A total of 969 local specialists were trained within the reporting quarter. By June 2014, such trainings will have been conducted in all oblast cities for specialists of all regions of Ukraine. Thanks to this work, it will be for the first time in Ukraine that Treasury servicing will be provided for all local budgets in the PPB format and generation of reports will be conducted based on the new approaches, which are in line with European practices.

See folder “Deliverables”

**Regional training on implementation of the Performance Program Budgeting method of planning and execution of local budgets, the city of Kyiv 15 October 2013**



***Sub-task 1.1.8: Provide advisory support to those local governments that have not been involved in the PPB pilot project***

- During the first and second years, IBSEER developed the existing local network of consultants who will help introduce PPB budgeting and will facilitate coordination between participants in the process. To implement the tasks of the second year of the project the consultants will collect, summarize, and submit for consideration by the Ministry of Finance the most important issues and promote the dissemination of recommendations for their resolution in the regions. To facilitate experience sharing among all the participants in the experiment and analyzing the progress of implementation of PPB budgeting, information from all the regions will be collected and processed on an ongoing basis. Best practices in PPB implementation will be highlighted on the MFSI-II website and in print publications.
- IBSEER will continue supporting the website section “Topical PPB Issues: Expert Answers column,” where visitors will be able to receive answers to their questions through interactive communication.

*Deliverable:* Annual experiment progress reports

*Timeline:* March 2014

*Result/Deliverable:* Running a column called “Topical Questions on PPB: Answered by Experts” on IBSEER web-page

*Timeline:* monthly

A new set of questions (22 for the reported period) with experts’ answers related to PPB has been placed on the site. In total, 151 answers to PPB-related questions have been prepared and posted on the website since the launch of the MFSI-II Project. The issues are regularly updated and relate to special circumstances of applying the Performance Program Budgeting methodology at the level of local budgets:

providing clarifications with regard to the rules and procedures of filling out budget requests, compiling passports of budget programs, using the codifier of budget programs, and conducting a comparative analysis of the performance efficiency of budget programs.

See folder “Deliverables”

## **Task 1.2: Review the legislation and analyze the execution of the State and local budgets of Ukraine. Provide support to operations of Interdepartmental Working Group**

### ***Sub-task 1.2.1: Advisory support to the interagency working group in finalizing the methodology, and the laws and regulations needed***

- IBSER will provide organizational support to the Ministry of Finance's Intergovernmental Working Group by organizing meetings and developing the relevant recommendations regarding PPB methodology implementation.

In 2011-2013, experts of the MFSI-II Project took part in nine meeting of the Interdepartmental Working Group. The meeting participants were considering the issues of amending the PPB methodology, including the following:

- improving the Standard lists of budget programs and of amending the relevant regulations;
- improving the Codifier of budgets programs, and building a transitional table from the Provisional Classification of Expenditures and Crediting of Local Budgets to the program classification of local budgets;
- matter of approval of budget programs by the participants of the PPB budgeting experiment;
- discussed the proposals of MFSI-II experts with regard to the topical issues of improving the treasury servicing of PPB-based budgets;
- set out the ways of speeding up the work of improving the software, which would allow automating the PPB-based planning of local budgets;
- focused on the topical issues of improving the treasury servicing of PPB-based budgets;
- reviewed the outcome of piloting the methodology of comparative analysis of budget program performance and ways of its improvement;
- discussed the progress of the experiment on introduction of components of the Performance Program Budgeting method.

*Result: Meetings of the working group will be held on a regular basis*

*Deliverable: Developed recommendations*

*Timeline: November 2013, February 2014, May 2014, September 2014*

**On 4 October 2013**, a regular meeting of the Interbudgetary Relations Task Force took place at the Ministry of Finance. The meeting was attended by specialists of the Ministry of Finance, State Treasury Service, line ministries, MFSI-II experts, and scholars.

The participants discussed the progress in implementing the 2013 National Action Plan, which includes the 2010-2014 Program of Economic Reforms.

The Task Force members supported the proposals by MFSI-II experts for improving the standard lists of budget programs, which were previously reviewed and approved at a meeting of the National Advisory

Board. Special attention was given to the relevance of performance indicators of the budget programs primarily devoted to improving the environmental situation in the regions and improving the population's health.

A decision was made for the line ministries to amend the Standard Lists of budget programs in the Education and Culture sectors with due consideration for the proposals developed by MFSI-II experts. The group also decided to finalize and approve the performance indicators of the budget programs relevant for the state of environment and population health.

The proposed modifications would allow to:

- evaluate the effectiveness of use of budget funds and the quality of services provided in the department of Education and Culture;
- assess the impact of budget expenditures on improvement of environment and health of the population.

The above will help improve the transparency of local budgets and stimulate local governments to take actions aimed at improving the environmental safety and population health.

**On December 25, 2013**, the Interbudgetary Relations Reform Task Force held its regular meeting in the Ministry of Finance of Ukraine. Representatives of the Ministry of Finance of Ukraine, State Treasury Service of Ukraine, branch ministries, MFSI-II experts and scientists participated in the meeting.

The task force members discussed and approved actions to improve software developed by the Ministry of Finance of Ukraine for the implementation of PPB at the local level. They also stressed on positive testing results for the software developed for financial authorities, and measures taken by the State Treasury Service of Ukraine for enhancing the automated system of treasury-based service of local budgets.

The representatives of the Ministry of Finance of Ukraine highly praised the work of MFSI-II experts in implementing PPB at the local level.

See folder "Deliverables"

***Sub-task 1.2.2: Help local governments assess draft laws affecting their revenues and resource allocation including the State Budget Bill to identify and mitigate potential risks for the local development***

To implement this task, IBSER will:

- analyze the Budget Declaration for 2015;
- analyze the provisions of the draft legislation aimed at amending the revenue base of local governments;
- analyze the Budget Law for the respective year;
- analyze the Changes to the Budget Law for the respective year, and ensure suggestions are incorporated in the Law (if such changes are approved by the Verkhovna Rada);
- analyze the Changes to the Tax Code, land laws, and other laws related to local budgets, which could affect revenues and resources.

*Result Analysis of the Budget Declaration for the next year is prepared and the suggestions to the document are accepted and incorporated in the text of the document*

*Timeline: April – June 2014*

*Deliverable: Analysis of the provisions of the draft legislation aimed at amending revenue base of local governments*

*Timeline: Ongoing process*



*Draft budget for the year 2014*

Experts of the MFSI-II Project have prepared an analysis of the Draft Law of Ukraine “On the State Budget of Ukraine for the Year 2014” No. 3000 of 18 December 2013. Summing up the key features of the Draft Law, note should be made of the following strengths:

- social orientation; and
- improved transparency of budget planning.

There are, however, fiscal risks, including:

- State guarantees;
- privatization of State property;
- borrowing; and
- the need to revise certain items and eliminate the hidden deficit of local budgets.

See folder “Deliverables”

*Result: Performance of an analysis of the Budget Law for the respective year is prepared*

*Deliverable: Analysis of the Budget Law for the respective year*

*Timeline: December 2013*

The Verkhovna Rada of Ukraine did not approve the Law of Ukraine "On the State Budget of Ukraine for the Year 2014" in 2013.

*Result: Analysis of the Changes to the Budget Law for the respective year is prepared and the suggestions to it are incorporated in the Law (in case such changes are brought for consideration of the Verkhovna Rada of Ukraine)*

*Deliverable: Analysis of the changes to the Budget Law*

*Timeline: Depending on the date of law adoption*

*Deliverable: Analysis of the Changes to the Tax Code, land laws, and other laws related to local budgets, which could affect their revenues and resources prepared*

*Timeline: Depending on the date of law adoption*

Experts of the MFSI-II Project have prepared an analysis of the changes in the tax legislation, which come into effect as of 1 January 2014. The key innovations are as follows:

- tax on immovable property is introduced;
- VAT rate is reduced from 20% to 17%;
- the enterprise profit tax rate is reduced from 19% to 18%;
- the rates of excise tax on pure alcohol and alcoholic beverages raised.

The evaluation of results from implementation of these changes is provided in the Analytical Note.

See folder “Deliverables”

***Sub-task 1.2.3: Help the GOU develop and review amendments to budget legislation that promote local level strategic planning and enable local governments to attract the private sector resources for the local infrastructure development projects;***

- ***Help the GOU develop and review amendments to the Budget Code and sub-laws that:***
- ***Enable all creditworthy communities to have access to credit resources to fund their infrastructure development projects;***
- ***Regulate the process of adoption by local governments of responsibilities and financial obligations within PPP arrangements;***
- ***Enable local governments separating energy efficiency savings from the rest of the budget and using these savings to reimburse implementers of performance contracts.***

Striving to assist cities in attracting resources of the private sector for implementation of infrastructure improvement projects, MFSI-II experts conducted three working meetings with the Public Private Partnership Development Program (P3DP) as part of the Memorandum of Cooperation signed by the Institute for Budgetary and Socio-Economic Research and P3DP on 2 October 2012. MFSI-II experts took part in a roundtable to discuss the Draft PPP Development Strategy in Ukraine for 2012-2017 and the Action Plan on 6 November 2012.

In November 2012, in order to remove the said barriers, MFSI-II experts updated their proposals for amendments to the Budget Code of Ukraine. The prepared amendments to the Budget Code of Ukraine have been forwarded to all stakeholders for review.

If necessary, MFSI-II experts will prepare other drafts changes to the legislative and regulatory framework, will submit them for roundtables / meetings of NAB discussion, and will develop the strategy for promoting these changes.

***Result: Development of draft changes to the legislation and regulations***

***Deliverable: draft amendments to the Budget Code (if needed); draft decrees of the Cabinet of Ministers (if needed); draft decisions of the State Treasury (regarding the issues of budget execution when implementing PPP projects) (if needed)***

***Timeline: October – December 2013***

During two years of implementation of the MFSI-II Project, MFSI-II experts took part in five working meetings and sessions of a Working Group on legislative regulation of application of such a component of public-private partnership as energy service contracts. The MFSI-II Project experts participated in the said meetings upon invitation from the Coordinating Center for Implementation of Economic Reforms under the President of Ukraine. This Working Group has been set up to address the issue of legal foundations for operation of energy service companies and implementation of energy service contracts. Representatives from the Ministry of Finance, Ministry of Economy, National Communal Services Regulatory Commission (National Commission), EBRD, and DTEK Company attended these meetings.

The Working Group considered, among other things, a Draft Law on amendments to the Budget Code of Ukraine. This Draft Law is needed to remove legislative barriers for introduction of energy service contracts. As a result, the meeting participants have supported inclusion into the legislative draft the proposals developed by the MFSI-II Project experts.

Within the third year of implementation, MFSI-II will take part in meetings and working groups on preparing other drafts changes to the legislative and regulatory framework of PPP implementation.

***Result: Preparation and organization of a round table/ meeting of NAB for all interested parties***

***Deliverable: Recommendations of roundtable participants with regard to the legislative proposals developed under this task.***

***Timeline: March 2014***

***Sub-task 1.2.4: Help local governments assess draft legislation affecting the local development such as Community Associations Bill and Regional Development Bill and suggest amendments with a focus on strengthening local revenues***

- IBSEER will review the draft legislation affecting local development and suggest amendments with a focus on strengthening local revenues (if an administrative and territorial reform is implemented, the said proposals will take the aspects of a new State system into consideration);

The MFSI-II Project experts took part in a working meeting on 17 February 2012, chaired by Anatoliy Blyzniuk, the Minister of regional development, construction, and housing and communal services of Ukraine. Discussed at the meeting were the main directions and priorities of implementation of the local government and regional development reform. MFSI-II experts reviewed the provisions of the draft Law of Ukraine “On Associations of Territorial Communities” No.9590 of 14 December 2011 with regard to the financial support to associated communities. Conclusions and proposals were prepared and forwarded to all stakeholders in 22 February 2012. After this, the proposals were considered at the roundtable meeting at the Committee on State Building and Local Government of the Verkhovna Rada of Ukraine on 12 March, 2012.

MFSI-II experts have reviewed the following:

- the Decree of the Verkhovna Rada of Ukraine dated 7 February 2012, No.4350-VI directed to send for the repeated first reading the draft Law of Ukraine on the foundation of the State regional policy, which was registered by the Verkhovna Rada on 1 June 2010, under No.6462.
- the Cabinet of Ministers of Ukraine Decree of 21 March 2012, No. 312 “On Approving the Procedure of Using in 2012 the Assets of the State Regional Development Fund.”
- the Cabinet of Ministers of Ukraine Decree of 4 July 2012, No. 656 “The Issues of the National Regional Development Fund
- the Law of Ukraine “On the State Budget of Ukraine for the Year 2013” part of the formationthe Regional Development Fund.
- the Resolution of the Cabinet of Ministers of Ukraine of 23 January 2013 No. 30 яка amended the Procedure for preparation, evaluation, and selection of the investment programs/projects, which can be implemented at the expense of resources of the State Regional Development Fund.
- the Cabinet of Ministers of Ukraine issued Ordinance of 20 March 2013 No. 149-r “Certain Issues of Utilization of State Capital Expenditures in 2013.”
- the Decree of the Cabinet of Ministers of 14 August 2013 No. 576 amended the Procedure of using the resources of the State Regional Development Fund approved by Decree of the Cabinet of Ministers dated 4 July 2012, No.656 “The Issues of the State Regional Development Fund.”

*Deliverable: The proposals based on the analysis findings prepared*

*Timeline: Ongoing process*

*Result/ Deliverable:*

The Law of Ukraine “On the State Budget of Ukraine for the Year 2014” establishes a Regional Development Fund of UAH 3.5bn for financing medium- and long-term programs and projects of socioeconomic development of the regions. This complies with the Budget Code standard, which states that the amount of the State Regional Development Fund should equal at least 1% of the estimated amount of General Fund revenues of the Draft State budget of Ukraine for the respective budget period.

In the period under review, there were no changes to the procedure of preparation, evaluation, and

selection of the investment programs/projects, which could be funded at the expense of the State Regional Development Fund, and the procedure of using the resources of the State Regional Development Fund.

- IBSEER will review the legislative changes aimed at financial support of regional development, in particular, for establishing a Regional Development Fund, and prepare its proposals intended for strengthening the financial resources of local governments.

*Deliverable: The proposals based on the analysis findings prepared (if changes are approved)*

*Timeline: April – June 2014*

### **Task 1.3. Implementing FARA Mechanism in the Budget Sphere at the National and Local Levels**

Contributing to the enhancement of international technical aid procedures and mechanisms in Ukraine, MFSI-II experts will help USAID to identify potential opportunities for implementing FARA mechanism in the budget sphere at the national and local levels. The experts will:

- review the current budgetary process and legislative framework governing the budgetary process with regard to the opportunity of applying FARA mechanism in the budget sphere;
- analyze in detail and examine USAID rules and procedures and possible experience of international organizations in implementing FARA mechanism in the budget sphere (including possible experience of other countries);
- provide recommendations of how to realize FARA mechanism in the budget sphere within the effective laws.

When the positive results on possible FARA implementation in the budget sphere are received, MFSI-II experts will: (i) develop possible financing road maps for implementation, considering the requirements of the Ukrainian budgetary process; (ii) follow legal changes which may concern it; (iii) provide recommendations on changes (if needed and positive results of possible implementation of FARA mechanism are received) to be made to legal and regulatory acts to implement FARA mechanisms in the budgetary sphere.

***Sub-task 1.3.1.: Assessment of opportunity of implementing FARA mechanism in the budget sphere. Provide based recommendations.***

*Deliverable: Assessment Report*

*Timeline: January 2014*

***Sub-task 1.3.2. \*: Development of possible financing road maps for implementing FARA mechanism in the budget sphere.***

*Deliverable: the developed financing road maps*

*Timeline: January - March 2014*

***Sub-task 1.3.3. \*: Provision of recommendations on changes (if needed) to legal and regulatory acts to implement FARA mechanism in the budgetary sphere.***

*Deliverable:* *the recommendations*

*(if needed) on legal and regulatory acts*

*Timeline:* *March 2014 - September 2014*

\* Carrying out the sub-tasks 2-4 depends on positive results on possible implementation of FARA mechanism, Assessment Report defined by the Sub-Task 1.

***Sub-objective A.1: Ensure institutional sustainability of the PPB training program(s).***

***Sub-task A.1.1: Conduct a study of the training centers that can offer PPB training sessions and methodological support to facilitate the introduction and effective application of PPB at the local level; identify those centers that are capable and interested in conducting PPB training sessions and providing methodological support on a regular basis***

According to the Project Workplan, IBSER had to start its selection of and collaboration with the Centers in 2012 році. In a timely manner, IBSER selected post-graduate educational institutions, which are capable of and interested in delivering PPB training sessions. Training centers were selected in the Kirovohrad, Odesa, Chernivtsi, and Zakarpatska oblast and in the city of Kyiv.

With IBSER's support, these organizations will develop and adopt the PPB training curriculum and materials and will conduct PPB training sessions to support the introduction of PPB at the local level. MFSI-II experts will organize and deliver PPB trainings for specialists of these organizations.

*Deliverable:* *Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex*

*Timeline:* *October – December 2013*

In collaboration with the Kirovohrad Center of Retraining and Qualifications Enhancement, MFSI-II experts held a training on practical PPB implementation on **2 October 2013**. On **10 October**, a similar event was held at the Zakarpattia Regional Retraining and Qualifications Enhancement, the first training at this location. Participants included heads of budgetary organizations and institutions, and a training-of-trainers approach was used to build the capacity of local PPB specialists who would go on to train others.

These activities completed the first series of training for specialists of the selected training centers. The trainees were introduced to the theoretical foundations of PPB, instructive materials, and practical aspects of its application in accordance with the methodology documents developed by the Ukraine Ministry of Finance. This develops a practical expertise of delivering PPB trainings, which will subsequently enable local government staff to acquire the knowledge and skills required for effective PPB implementation.

See folder "Deliverables"



***Sub-task A.1.2: Help those training centers to develop a PPB training curriculum and PPB training materials and to conduct at least 50 PPB training sessions for relevant GOU officials***

IBSER will hand over the PPB Handbook developed under Sub-task 1.1.4 to the selected training centers and will assist with the PPB training curriculum, as well as conduct at least 50 PPB training sessions with the specialists of such training centers. During the third year of project implementation, MFSI-II experts will deliver at least 30 PPB training sessions with the specialists of such training centers.

*Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex*

*Timeline: January – June 2014*

**On 29 October 2013**, specialists of the Chernivtsi Regional Retraining and Qualifications Enhancement Center conducted their first PPB training independently. The training was attended by the staff of central government offices, local governments, State-owned enterprises, institutions, and organizations.

Similar training was conducted at the Kirovohrad Regional Retraining and Qualifications Enhancement Center on **28 and 29 October 2013**. A focused short-term seminar with the heads and specialists of the oblast and raion finance directorates was held at the Center.

**On 13 December 2013**, as part of the Memorandum of Cooperation with the Kyiv City Retraining and Qualifications Enhancement Centers, the MFSI-II experts delivered training on the methodological foundations of PPB. The training was conducted under the professional qualifications enhancement program for public servants of categories V through VII.

These trainings continued realization of the MFSI-II Project tasks of ensuring institutional sustainability of PPB training programs. These practices would help implement the PPB methodology at the Training Centers, which would provide an ongoing PPB training.

On the whole, as part of collaboration with the Training Centers (*Sub-task A.1.1 and Sub-task A.1.2*), 226 local specialists were trained in the reporting quarter, including 198 women and 28 men.

See folder “Deliverables”

***Objective B: Develop and introduce financial practices that foster energy efficiency in 15 selected cities***

**Task 2.1: Assist the cities in introducing an effective system of managing energy savings in the public sector**

- IBSER will improve the unified methodology developed during the first year of project implementation and will select four Ukrainian cities for the third year of the project. IBSER will coordinate selection with Public Private Partnership Development Program and Developing Initiative for Advocating Local Governance in Ukraine (DIALOGUE).
- To assist the cities in developing well-founded energy efficiency programs, IBSER will update a system of monitoring of energy expenditures based on PPB method for the selected four cities, which

is based on similar system developed for the cities selected for the first and second year of the project. In order to implement this system and based on the experience of MFSI-II Project accumulated in the first and second year of implementation, IBSER will update the training materials on implementation of the said system and will conduct training for specialists of key spending units in the four cities selected for its application.

During the first and second years of project implementation, the MFSI-II experts selected 11 Ukrainian cities (6 cities selected in 2012, 5 cities - in 2013). The total amount of loans granted by NEFCO is 182.9 million. These financial resources of the city directed at implementing energy efficiency projects. Implementation of all projects will have a significant social, economic and ecological impact for cities and reduce CO<sub>2</sub> emissions by 4499,6 tons per year.

MFSI-II experts have analyzed the energy expenditures of municipal budgets for heating, electricity, and natural gas in 2008-2011 and gave recommendations for the project cities.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”).

MFSI-II experts prepared their assessments of the creditworthiness of the cities and made the relevant conclusions. Creditworthiness conclusions contain, among other things, a review of the sources of revenues of municipal development budgets, structure of expenditures, which reflects municipality’s ability to allocate resources for the development needs etc.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”).

MFSI-II experts updated the system for monitoring energy-related budget expenditures for the selected cities. The new system has been brought in conformity with the latest changes in the Ukrainian budget legislation. Also, the system has been streamlined by reducing the number of indicators it contains.

Accomplished (see “Quarterly Report 01 March – 31 July, 2013”)

Based on an updated system of monitoring and evaluation of efficiency of budget expenditures for utilities and energy (based on the Performance Program Budgeting method), MFSI-II experts have updated the respective training materials and presented it on the seminar “Financial Mechanisms of Improving Energy Efficiency in the Budgetary Sphere”.

*Result/Deliverable: Four Ukrainian cities for the third year of the project are selected using the developed unified methodology*

*Timeline: October – December 2013*

The selection of cities for participation in the third year of the MFSI-II Project has been conducted according to an improved version of the selection methodology developed in the first year of the Project.

Based on the competition results, the cities of Kyiv, Luhansk, Sievierodonetsk, Kamyanets-Podilsky, Slavutych, Eupatoria and Kryvyi Rih have been selected and the Memoranda of Cooperation have been concluded with these cities.

The issues of energy efficiency and energy saving are appropriately reflected in the policies of respective city councils of the selected cities. For example:

- a municipal energy saving program for 2012-2016 approved in Kyiv;
- energy efficiency and energy saving programs for 2011-2015 are being implemented in Luhansk and Sievierodonetsk, also Sievierodonetsk has a municipal energy plan for 2011-2015;

The cities must not only strive to improve their energy efficiency, but should also undertake practical

energy saving activities/projects. Therefore, the existence of such projects was one of the criteria in the city selection. All the chosen cities meet this criterion, for example:

- projects “Modernization in Municipal District Heating - demand management” and “Projects in the field of street lighting of Luhansk city: modernization of street lighting using energy efficient technologies and alternative energy sources”(Luhansk);
- projects “Thermal rehabilitation in budgetary institutions of Kyiv city” (Kyiv), and others.

Collaboration of the cities with the MFSI-II Project will help the cities to improve their energy efficiency, will facilitate establishment of an effective energy saving system (through development of a system for monitoring of energy expenditures), and provide financial incentives for energy saving in the budgetary sphere. The participation of city representatives in the seminars, working meetings, and other events organized by the MFSI-II Project will create opportunities for experience-sharing and for learning from the best domestic and international practices of improving the energy efficiency at the local level.

See folder “Deliverables”

*Continued collaboration with the Year Two project cities.*

With the advisory support provided by the MFSI-II Project, the city of Lutsk received approval from the Ministry of Finance of Ukraine with regard to the amount and conditions of a loan for financing the Implementation of Energy Saving Activities in the Lutsk Municipal Budgetary Institutions investment project.

The project’s objective is the implementation of energy saving activities in six public buildings in the city of Lutsk, including schools, children’s educational institutions, and one city hospital.

The realization of the project includes a comprehensive set of energy efficient activities, namely:

- replacing windows and doors, and insulating roofs and external walls;
- modernizing lighting systems;
- heat insulation etc.



After completing all of the activities, heat energy savings are expected to amount to 1275,4MW per year, electric power 94.1MW per year, and an aggregate CO2 emissions reduction of 427.1 tones per year.

The successful completion of the Implementation of Energy Saving Activities in the Lutsk Municipal Budgetary Institutions project will save UAH 1 million of public funds per year and will improve the level of comfort and state of health of both adults and children.

The project is one example of how the partnership between the MFSI-II project and the city of Lutsk in this field will significantly and positively affect the municipality’s socioeconomic and natural environments.

## **Task 2.2: Assist in designing and implementing financial incentives to promote the establishment of effective energy savings systems in the public sector**



- IBSER experts will help municipalities design and introduce financial incentives to promote the establishment of effective energy savings system in the public sector.
- If needed, a review and improvement of the budget legislation needed for implementation of the said financial incentives will be carried out under Task 1.2.3.
- To help the chosen municipalities introduce the financial incentives that foster energy efficiency, IBSER will provide advisory support to the municipalities in designing budget programs, in particular, those intended for the realization of individual investment projects.

Updated Recommendation on financial incentives to promote the establishment of an effective energy savings system in the public sector have been presented on **5 April 2013** at the 11th Forum “Energy Efficiency of Budget Expenditures as a Road to Economic Prosperity”. To facilitate practical application of the above-mentioned Recommendations, the MFSI-II experts provided consultations to the city of Zhytomyr with regard to the Procedure of using the funds saved in utilities and energy costs. The MFSI-II experts helped to prepare a draft Zhytomyr City Council resolution approving this Procedure.

Accomplished (see “Quarterly Report 01 March – 31 July, 2013”).

*Deliverable: Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector are updated and presented at a session of the National Advisory Board.*

*Timeline: October 2013 – December 2013*

MFSI-II experts at the National Advisory Board (NAB), which held on December 24, 2013, introduced suggestions on how to settle issues that arise when implementing loan-financed energy effective projects. The current situation carries certain risks of local debt repayment with the saved energy resources funds resulted from these projects. Meeting participants agreed that the issue was of high importance and it would be necessary for MFSI-II experts to develop a respective regulatory act.

Settling this issue will fulfill the terms and conditions of the loan for implementing energy effective projects, and improve solvency of local governments’ energy budgets.

See folder “Deliverables”

*Deliverable: Consultations on system implementation provided to the cities, including for development of budget programs and individual investment projects.*

*Timeline: October 2013 – September 2014*

MFSI-II experts are providing systematic consultations to the Project cities on implementation of a system of financial stimulation for efficient use of energy resources by budgetary institutions, including the development of budget programs and individual investment projects. Also MFSI-II suggested to address certain additional issues for each local council.

### **Task 2.3: Assist partner municipalities in building capacity of municipal enterprises to conduct modern financial analysis and planning to support their strategic and annual plans**

The IBSER experts assisted the partner cities in strengthening the capacity of communal service enterprises to carry out a financial and economic analysis and planning as part of their strategic plans and action plans, including their coordination and matching with the municipality's strategic goals and objectives.

During the first and second years of project implementation, the MFSI-II experts have developed the training materials for conducting the monitoring and evaluation of the energy efficiency projects implemented by municipal enterprises.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

MFSI-II experts presented a methodology of monitoring and evaluation of energy performance projects and their recommendations for improving the effectiveness of financial justification of strategic documents by communal service enterprises at a seminar held on 29 March 2013. Based on the seminar results, the MFSI-II experts forwarded letters with the presentation materials to the participants to provide their comments and highlight issues.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

*Deliverable: Report prepared on the number of trainings on the monitoring and evaluation of energy efficiency projects implemented by municipal enterprises and implementing of the methodology of financial and economic justification of strategic and planning documents of municipal enterprises consistent with the municipality’s strategic goals held and the number of specialists who participated in trainings with a breakdown by sex*

*Timeline: January – March 2014*

*Deliverable: Consultations to the staff of municipal enterprises on using the methodology provided*

*Timeline: October 2013 – September 2014*

The communal service enterprises of the Project cities are receiving ongoing assistance and online consultations from MFSI-II experts on the monitoring and evaluation methodology of energy performance projects and recommendations for improving the effectiveness of financial justification of strategic documents.

### ***Objective C: Enhance public awareness of the public budgeting process, revenues and expenditures***

#### **Task 3.1: Analyze the execution of budgets at all levels and analyze the budget legislation, disseminate impartial information**

IBSER will prepare an independent budget implementation and budget legislation analysis to support the efficient and transparent implementation of local budgets. Thus, work will continue to analyze the execution of budgets at all levels and analyze budget legislation. In particular, in order to ensure the monitoring of the impact of the changes to the local revenues legislation, the IBSER will conduct a constant monitoring of the budget process in all of its stages. The results of the monitoring will be presented in monthly and quarterly publications dedicated to the analysis of the budget execution. The results of the monitoring and analysis conducted will be disseminated among all the stakeholders and partners.

*Result: IBSER experts will prepare a monthly monitoring of national and local budget implementations and place it on the IBSER’s Web-site (web-page).*

*Deliverable:* *Monthly monitoring*

*Timeline:* *The monthly monitoring in electronic form is prepared and placed on the IBSER's Web-site (web-page) by the end of second week of every month*

In the reporting timeframe, the project prepared monthly monitoring reports (three for the reported period) on the implementation of the state and local budgets for the period from August 2013 to October 2013 (See "PMP"). The reports were placed on the website. On the whole, there were 18 monthly monitoring reports prepared and published on the website since the launch of MFSI-II.

See folder "Deliverables"

*Result:* *Monitoring of the budget and fiscal impacts on local budgets in form of a full-scale analysis of the budget process*

*Deliverable:* *Budget Monitoring*

*Timeline:*

*The Monitoring for Quarter 3, 2013 is placed on the IBSER's Web-page by December 31, 2013.*

*The Monitoring for Quarter 4, 2013 is published, distributed among the IBSER's partners, and placed on the IBSER's Web-page by March 31, 2014.*

*The Monitoring for Quarter 1, 2014 is placed on the IBSER's Web-page by June 30, 2014.*

*The Monitoring for Quarter 2, 2014 is published, distributed among the IBSER partners, and placed on the IBSER's Web-page by September 30, 2014.*

*Result/ Deliverable:*

In total, there were eight quarterly monitoring reports prepared and published on the website since the beginning of the MFSI-II Project.

According to the State Treasury preliminary data, MFSI Project experts prepared the *Budget Monitoring for January–September 2013* (See "PMP").

The monitoring included an analysis of the latest trends regarding the State and local budget execution, as well as an analysis of the legislative acts influencing the budget process, approved over the reporting period. *The Budget Monitoring* was distributed among the interested parties and stakeholders, and placed on the website. Key highlights include:

**The macroeconomic situation** changed only marginally in the period under review, and is characterized by the instability related to disparities in economic development of the regions and dependence on import of energy resources.

**The nominal GDP** totaled UAH 1,046.1bn, which is UAH 15.8bn or 1.5% more than last year's figure.

**The real GDP** decreased by 1.3ppt (in constant 2007 prices) during nine months of the year, with the 2012 situation being identical.

A trend towards a decline of production output continued in January-September 2013. The highest production decline rates in the manufacturing sector are observed in the production of vehicles, trailers, and semi-trailers (by 21.1ppt), chemical products (by 20.2ppt), and tobacco products (by 13.4ppt).

**The consumer price index** remained basically unchanged throughout January-September 2013 (against last December) and amounted to 99.4%.

**The producer price indices** were the lowest in the last five years. The producer price indices increased by 102.1% on average year-to-date.

**The foreign trade balance of Ukraine** was a negative one, showing a 0.7 times worsening against last year's figure and amounting to \$4.6bn, which testifies to insufficient competitiveness of Ukrainian products on world markets and imports' excess over exports.

**The nominal average monthly pay** per full-time employee amounted to UAH 3,261.0 during nine months of 2013, which is nearly 9.6% more than last year's figure. This exceeds the State social standards (minimum wage level and able-bodied person's subsistence level of UAH 1,147) 2.8 times.

The rate of growth of **real wages** declined; it amounted to 9.1% (14.9% in the same period of 2012).

The level of execution of the **consolidated and State budget revenues** points to the risks of non-fulfillment of the annual plan. The highest probability of annual plan shortfall exists for the value-added tax and taxes on international trade and external transactions (the expected shortfall for these revenues could reach 15.0%) There are also grounds to expect a shortfall from the personal income tax, which is the key source of **local budget revenues** (the estimated plan shortfall could reach 7.0%).

Unlike last year, surplus could be expected against the annual plan for some revenue items. For the State budget, this applies to the enterprise profit tax, where surplus could reach 1.0%-3.0% or UAH 1.0bn-1.5bn. For the taxes assigned to local budgets, a surplus of 27.0% to 30.0% could be expected for the single tax on small businesses.

A significant slowing-down in the rate of growth of tax revenues is a distinct feature of this period. Thus, the said revenues of the State budget were 2.8% below the respective last year's figure in the first half of the year.

The abovementioned characteristics of the budget process with regard to the revenues have led to changes in the structure of revenues both of the consolidated and State budgets. The most significant change is a decline in the share of tax revenues (by 2.4ppt and 3.6ppt, respectively), with the share of non-tax revenues increasing accordingly.

The level of execution of **consolidated budget expenditures** decreased slightly (by 0.5ppt) compared to January-September 2012 and amounted to 65.3%.

The rate of growth of consolidated budget expenditures decreased by 10.0ppt and amounted to 106.9%. This year, however, it exceeded the GDP growth rate, which was significantly lower than last year. Therefore, the share of consolidated budget expenditures in GDP increased to 34.3% or by 2.1ppt.

The share of local budget expenditures in the consolidated budget expenditures decreased by 0.9ppt year-on-year and amounted to 43.5%.

**The State budget expenditures** were executed at UAH 285.3bn, which amounts to 65.7% of the annual plan.

The best funded were the expenditures for social protection and social security (74.1% of the annual plan, which is 3.3ppt more than last year), intergovernmental transfers (69.4%), education (66.6%), public order, security, and judiciary (65.9%). As usual, the lowest funding levels were noted for expenditures for the housing and communal services sector. The funding for this sector totaled UAH 40.0mn or 33.4% of the annual plan during nine months of this year.

**Structure of Revenues of the Consolidated and State Budgets of Ukraine  
in January-September 2011–2013**

(%)

Revenues	Consolidated budget			State budget		
	2011	2012	2013	2011	2012	2013
<b>Tax revenues, including:</b>	<b>84.5</b>	<b>82.9</b>	<b>80.5</b>	<b>84.4</b>	<b>82.1</b>	<b>78.5</b>
– enterprise profit tax	13.6	12.5	13.1	17.3	16.1	16.9
– value-added tax	33.2	31.8	28.8	42.4	41.2	37.6
– excise tax	8.7	9.2	8.5	10.8	11.6	10.8
– taxes on foreign trade and external transactions	2.9	3.1	3.0	3.7	4.0	3.9
<b>Non-tax revenues</b>	<b>14.6</b>	<b>16.4</b>	<b>18.9</b>	<b>15.3</b>	<b>17.7</b>	<b>21.2</b>
<b>Income from capital transactions</b>	<b>0.5</b>	<b>0.5</b>	<b>0.3</b>	<b>0.1</b>	<b>0.1</b>	<b>0.01</b>
<b>Targeted fund</b>	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>
<b>Other revenues</b>	<b>0.1</b>	<b>0.0</b>	<b>0.1</b>	<b>0.1</b>	<b>0.0</b>	<b>0.2</b>



The key priorities of the State policy, as manifested in increased State budget expenditures against last year (the total increase amount of UAH 18.1bn), included social protection and social security (47.78% of all increase in expenditures); general government (23.5%, including 96.2% for debt servicing); public order, security, and judiciary (11.0%); and intergovernmental transfers (8.6%).

**The local budget expenditures** increased by 5.0% and totaled UAH 157.5mn. The annual plan approved by local councils was executed by 66.5%. As usual, the majority of local budget expenditures are used in the social and cultural sphere (86.0%, which is 2.8ppt more year-on-year). At the same time, the expenditures for social protection and social security increased (by 1.9%) in the period under review, while the expenditures for the housing and communal services sector and economic activity decreased (by 1.7% and 0.9%, respectively).

In general, the monthly trend of local budget expenditures follows the trends of previous years, except for August, when expenditures decreased by 18.9% compared to July. The local budget expenditures increased by 17.1% in September vs. August, and almost reached the similar last year's figure.

An 1.9ppt growth is observed in the share of local budget expenditures for current transfers to the population (up to 23.7%). Also, an 1.1ppt increase is noted in the share of expenditures for payroll with taxes, which are typically the largest from among all the local budget expenditures and which amounted to 48.0% in January-September 2013; and a decrease by 1.1ppt in the share of expenditures for utilities and energy (down to 5.6%). In general, the current expenditures of local budgets totaled over UAH 147.6bn, which is nearly 6.0% more than during nine months of 2012. Capital expenditures were funded at UAH 9.9bn and their amount decreased by UAH 0.8bn or by 7.9%.

**The State budget deficit** totaled UAH 35.2bn, which amounts to 69.6% of the ceiling set by the Law on the State Budget of Ukraine for the Year 2013. Compared to the respective last year's indicator, the State budget deficit increased by UAH 10.7bn or by 43.7%.

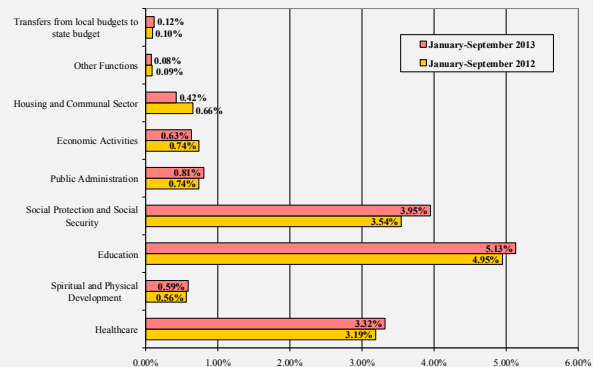
**The State budget borrowing** totaled UAH 107.0bn (78.9% of the annual plan). Internal borrowing totaled UAH 80.5bn or 86.7% of the annual plan, and external borrowing totaled UAH 26.5bn or 62.1%. **State debt repayment** totaled UAH 54.8bn, which amounts to 67.6% of the annual plan. It includes internal debt repayment of UAH 29.6bn or 65.2% of the annual plan, and external debt repayment of UAH 25.2bn or 70.8%. The excess of borrowing over repayment increased 1.4 times compared to last year.

According to the State Treasury Service, **the amount of loans for covering temporary cash gaps of local budgets** granted from the Single Treasury Account totaled UAH 37.0bn, which is 2.3% more year-on-year. Repayment of those loans totaled UAH 34.3bn compared to UAH 33.1bn in January-September 2012.

**The revenues from privatization of State property** totaled UAH 0.9bn or 8.4% of the annual plan. Such revenues totaled UAH 5.4bn or 53.5% of the annual plan in the same period of last year.

**The balance of budget funds** totaled UAH 32.8bn as of the end of September 2013, showing a growth of UAH 5.7bn since the beginning of the year. This balance decreased by 34.2% year-on-year.

**Share of Local Budget Expenditures in GDP  
in January-September 2012-2013**



See folder "Deliverables"

### **Task 3.2: Conducting public events and engaging the public in the budget process**

In order to efficiently engage the public in the budget process and sound the public opinion, IBSER will support the holding of public hearings. IBSER will continue its practices of holding meetings of the National Advisory Board and the Financial and Economic Forums on an ongoing basis with an invitation extended to all interested parties, including to representatives of the general public. In order to ensure the broadest possible dissemination of information at the local level and raising the level of public awareness, use will be made of all available mass media and other formats, such as holding of public hearings, publication of printed materials etc

#### Result/Deliverable:

*Participation of IBSER experts in working meetings, roundtables, conferences, including international ones, radio and TV talk shows with the aim of disseminating information on the issues addressed by the project*

Timeline: Ongoing process

**On 15 October 2013** the MFSI-II Project took part in a roundtable discussion called, *Improving the Regulatory Framework for the Introduction of the Mechanism of Energy Service Contracts in Budgetary Institutions*. The roundtable was held as part of the implementation of the National Action Plan for 2013.

The meeting focused on the regulatory reform needed to improve the legislative environment for attracting investments in the energy efficiency sector, in particular, attracting investments for improving the energy efficiency of public buildings in Ukraine.

The participants considered two relevant legislative drafts registered with the Verkhovna Rada of Ukraine.

These drafts are designed to remove existing barriers to the introduction of energy service contracts in the budgetary sphere. The drafts contain Project proposals intended to shape the regulation of attracting private capital for implementing energy saving activities in budgetary institutions.

As we have already stated in previous reports, in the opinion of the Project, the legislative draft developed under the leadership of the National Commission for State Regulation of Public Utilities (National Commission) is more mature, contains less risks, and is based on systemic approach. Among other things, it provides maximum protection to:

- 1) energy service companies by the statutory inclusion of the expenditures required to pay for the services of such companies under energy service contracts into local budgets;
- 2) cities from the failure of energy service companies to meet contracts and obligations, as payment for work will only be made based on actual savings.

Wrapping up the meeting, Minister Temnyk of the Ministry of Regional Development and Housing and Communal Services emphasized the need for coordinating the two legislative drafts submitted to the Verkhovna Rada and combining them into a single document. To this end, it is planned to set up tightly defined working groups.

On the whole, the approval of the amendments to the legislation will make it possible to:

- Introduce a transparent and coherent scheme of concluding and implementing energy service contracts;
- Increase the attractiveness of budgetary institutions for potential investors in the energy performance sector by guaranteeing the protection of their rights;
- Reduce the energy dependence of Ukrainian municipalities.

According to the Work Plan and striving to achieve the MFSI-II Project objectives, the Project experts are working together with other projects to submit legislative proposals, address the issues of energy efficiency at the local level and resolve other issues.

As part of this collaboration and upon invitation of the Association of Ukrainian Cities (which is

implementing the Dialogue Project), MFSI-II Project experts took part in a meeting of financial officers of Ukrainian cities. The event was held **on 31 October through 1 November 2013**, in the city of Zhytomyr, which has been participating in the MFSI-II Project since 2012.

The trip was intended to strengthen contacts with other stakeholders in order to finalize the legislative changes for implementation of energy service contracts in the budgetary sector.

The meeting participants emphasized an urgent need of attracting private investors in implementation of energy performance projects in buildings of budgetary institutions and adopting the relevant amendments to the legislation. At the same time, certain reservations were voiced with regard to one of the legislative drafts, which proposes to introduce exclusions in the general approach to the budget process. This, however, would disrupt the integrity of the whole this process.

For their part, the MFSI-II Project experts have already contributed their efforts to the formation of a systemic approach to implementation of energy service contracts in the budgetary sector. This approach is reflected in the legislative draft developed by the National Commission for State Regulation in the Public Utilities Sector.

The MFSI-II Project experts will continue taking part in further elaboration of the said legislative amendments, in particular, by joining forces with experts of the Dialogue Project.

The MFSI-II Project has been invited to join in the work of developing proposals for improving the Action Plan for implementation of the Public Finance Management Strategy of Ukraine approved by ordinance of the Cabinet of Ministers of Ukraine.

This work was conducted **on 18 through 22 November 2013** at the Ministry of Finance of Ukraine as part of the consultations between experts of the Ministry of Finance, other agencies, and representatives of the donor community.

The MFSI-II Project experts provided their proposals on the issues of Performance Program Budgeting at the levels of the State and local budgets, medium-term budget planning, improving transparency of the budget process, and other issues relevant for the process of developing the public finance management system of Ukraine.

The proposals contributed by the experts will be incorporated in an updated version of the Action Plan for implementation of the Public Finance Management System Development Strategy.

**On 22 November 2013**, MFSI-II experts participated in a teleconference, which took place at EBRD with participants from Russia and the United Kingdom. The Ukrainian side was also represented at the teleconference by USAID and USAID's Municipal Energy Reform Project in Ukraine (MERP). Discussed at the meeting were the ways of improving the legislative amendments with regard to the legal foundations for operation of energy service companies and implementation of energy service contracts.

As is known, there are two legislative drafts on this issue: one developed with support from EBRD, and another with support from the National Public Utilities Regulatory Commission (the "National Commission"). Even though MFSI-II experts participated in developing both bills, the latter incorporates all the proposals made by the MFSI-II experts. We believe this draft is more mature, contains less risks, and is based on systemic foundations, while the EBRD legislative draft will need further elaboration.

Following the discussion, the participants decided to join efforts in developing the updated changes to the budget legislation and procurement legislation. The well-founded, finalized amendments to the budget legislation will be submitted to the Ministry of Finance of Ukraine.

The EBRD representatives from the United Kingdom have outlined the main directions of work in this area: 1) prepare a short document with key principles of energy service contracts; 2) develop a mechanism for implementation of such contracts; and 3) draft the agreed amendments to the Budget Code.

The abovementioned amendments should:

- not effect the deficit of budgets and amounts of the State and local debts;
- ensure the legitimacy of conclusion of contracts by budgetary institutions for a long-term period;

- envisage payments under energy service contracts only within the amounts of saved funds. Adoption of the finalized amendments to the Budget Code will ensure:
- transparency of arrangements for concluding and implementing energy service contracts;
- attractiveness of the budgetary sphere for potential investors in the energy performance sector by means of guaranteeing the protection of their rights;
- reducing the energy dependence of Ukrainian cities.

*Result: Preparation and organization of Financial-Economic Forum*

*Deliverable: Minutes of Financial-Economic Forum, agenda and recommendations of Forum participants*

*Timeline: February 2014, September 2014*

*Result: Preparation and organization of a National Advisory Board*

*Deliverable: Minutes of a National Advisory Board and agenda*

*Timeline: December 2013, March 2014, June 2014, August 2014*

**On December 24, 2013**, the National Advisory Board (NAB) held a meeting on effective public finance management. The representatives of the Ministry of Finance of Ukraine, State Treasury Service of Ukraine, local financial authorities, scientific circles, international expert environment, public sector and other leading experts in the sphere of regional and local development participated in the meeting.

Within the meeting, the participants approved the offers of MFSI-II experts aiming at improving the PPB methodology and legislative basis. These changes will allow settling problems, which may arise when forming local budgets based on the PPB.

See folder “Deliverables”

**Meeting of the National Advisory Board (NAB) on efficient management of public finance, 24 December 2013**



*Result/Deliverable: Regular updating of IBSER's website with information regarding project activities*

*Timeline: Ongoing process*

The MFSI-II web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II project experts participated in the period October – December 2013 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (electronic versions), prepared in the period October –



December 2013, have been placed on the site in the Subsection – “Analytical materials” (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All articles published in national and regional media in October – December 2013 have been monitored and converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

New set of questions in section “Experts’ answers” with experts answers related to PPB section has been regularly added on the site, the information was regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation, was updated.

*Result: Preparation of Electronic bulletin intended for the publication of news on project activities for electronic mailing to addressees in the database of IBSER partners*

*Deliverable: Electronic bulletin*

*Timeline: October 2013, January 2014, April 2014, July 2014*

One Bulletin issue (#39 October – December 2013) has been prepared in Ukrainian and English and e-mailed to more than 660 partners. It is also placed on the project web-site in the “E-Bulletin” section. Overall, seven Bulletins have been prepared since the launch of the MFSI-II Project. The number of E-bulletin subscribers increased by 25 between October to December 2013.

See folder “Deliverables”

*Result/Deliverable: Publication «Innovative Practices of the Local Finance Management».*

*Timeline: March 2014*

*Result: Support the holding of separate information public events in partner cities*

*Deliverable: The report on implementation of information public events in localities prepared*

*Timeline: February 2014, August 2014*

*Result: Delivery of training on budget issues for NGOs*

*Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender*

*Timeline: January – March 2014*